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Date: APRIL 29, 2009

LEGEND:

Decedent =

Trust =

CLAT =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Daughter 1 =

Daughter 2 =

Son 1 =

Son 2 =

Daughter's =

Spouse

Grandchild 1 =

Grandchild 2 =

Grandchild 3 =

Charity =

Company =

a =

b =

w =

x =

y =

z =

Dear _____ :

This letter responds to a letter dated October 29, 2008 and other correspondence, requesting rulings on behalf of Trust regarding the allocation of Decedent's generation-skipping transfer (GST) exemption.

The facts submitted are as follows. Decedent created CLAT and an irrevocable trust for the benefit of Daughter 1 and her issue (Trust) on Date 1, a day between September 25, 1985 and October 22, 1986. On Date 1, Decedent funded CLAT with \$w in cash and x shares of nonvoting Class A common stock in Company valued, pursuant to an appraisal, at \$y; Decedent funded Trust with \$z in cash. No additional contributions were made to Trust and CLAT during Decedent's life.

Under the terms of CLAT, the trustees were to pay Charity a guaranteed annuity of \$a per year, during the trust term, which was to end on Decedent's date of death. At Decedent's death, after paying all amounts due to Charity, the trustees were to distribute the remaining principal and income in pro rata equal shares to Trust, Daughter 2, Son 1, and Son 2. The share of a then deceased individual would be paid to that individual's then living issue, per stirpes. If Trust had already distributed all of its assets, the share for Trust would be paid to Daughter 1.

Under the terms of Trust, upon its creation, the trustees were to divide Trust, into separate equal trusts, one for each of Daughter 1's then living children and that child's issue (Grandchild's share). During Daughter 1's life, the trustees were to pay her all of the net income of Trust and as much principal as may be necessary to maintain her in her accustomed manner of living. Any payments were to be charged equally to each Grandchild's share of Trust. Daughter 1 was granted the power during her life to appoint any part of Trust to any of her issue but not in satisfaction of Daughter 1's legal obligation of support. After the death of Daughter 1 during Decedent's life, the trustees are authorized to pay to each child of Daughter 1 (or to the descendants of a deceased child of Daughter 1) from time to time, such sums of income and principal as the trustees, in their absolute discretion, deem to be in the best interests of such beneficiary; any distribution will be charged against the beneficiary's respective share. When a child of Daughter 1 reaches age 35, the trustees are to distribute one-half of the child's share outright to the child. When the child reaches age 40, the trustees are to distribute the balance of the child's share outright to the child. If a child of Daughter 1 dies before reaching age 40, the trustees are to distribute the deceased child's share to the child's then living descendants, per stirpes, or if none, to Daughter 1's then living descendants, per stirpes, or if none, to Decedent's then living descendants, per stirpes. At the death of the second to die of Decedent and Daughter 1, the trustees will distribute, to each child of Daughter 1 who has reached age 35, but not age 40, one-half of that Grandchild's share and will hold the balance until the child reaches age 40. Trust terminates upon distribution of all shares, but no later than 21 years after the death of the last to survive among Daughter 1 and all of her issue alive on Date 1.

Son 1 and two nonfamily members are named as the initial trustees of Trust. Daughter 1 and Daughter 1's Spouse are named as successor trustees. Trust prohibits Daughter 1 from participating as trustee in any decision regarding discretionary distributions to her and from participating in any decision regarding allocations of receipts or expenses to income or principal while serving as trustee. The trustees must act by majority decision.

The trustees of Trust are authorized to commingle the assets of any trust created under Trust in one or more consolidated funds. Upon the creation of Trust, Daughter 1 had three children, Grandchild 1, Grandchild 2, and Grandchild 3. The trustees commingled the assets and administered Trust as one combined trust.

The Form 709, United States Gift Tax Return (Form 709), to report Decedent's Date 1 transfers was timely filed on a date before October 22, 1986. On the gift tax return, Decedent reported the gift to CLAT and claimed a gift tax charitable deduction under § 2522. Decedent died on Date 2, after September 25, 1985 and before October 22, 1986. Daughter 1, Daughter 2, Son 1, and Son 2 survived Decedent.

Within two weeks after Decedent's death, the trustees of CLAT made a final annuity payment to Charity and distributed the remaining assets of CLAT in pro rata equal shares to Trust, Daughter 2, Son 1, and Son 2. On or about Date 3 (after October 22, 1986), Decedent's estate filed Form 706, United States Estate Tax Return (Form 706), and did not allocate any GST exemption to Trust or CLAT on the return.

Daughter 1 died on Date 4. Grandchild 1, Grandchild 2, and Grandchild 3 survived Daughter 1. Grandchild 1 has reached age 40. Grandchild 2 will reach age 40 on Date 5, and Grandchild 3 is between ages 35 and 40. Thus, Daughter 1's death caused a taxable termination of Trust as that term is defined in § 2612(a) of the Internal Revenue Code. As required under § 2662(a)(2), the trustees will file a return and pay the tax on the taxable termination from Trust no later than Date 6. After paying the GST tax, the trustees will distribute one-third of Trust to Grandchild 1, one-third to Grandchild 2, and one-sixth to Grandchild 3. The trustees will continue to hold Grandchild 3's remaining share in Trust until Grandchild 3 reaches age 40 on Date 7.

Taxpayer has requested the following rulings:

1. Upon Decedent's death, she had an unused GST exemption of \$1,000,000.
2. Decedent's unused GST exemption was automatically allocated to Trust under § 2632(c) in effect on October 23, 1986, based on the date of death value of Trust, including the value at Decedent's date of death of Trust assets attributable to Decedent's Date 1 transfer of \$z to Trust plus the assets transferred from CLAT to Trust upon Decedent's death.

3. Upon the automatic allocation of Decedent's GST exemption to Trust, for purposes of computing the inclusion ratio of Trust, the denominator of the applicable fraction determined under § 2642(a)(2) should be computed based on the date of death value of the assets of Trust.

4. The numerator of the applicable fraction will be Decedent's entire \$1 million GST exemption allocated to Trust as discussed above. The denominator will be the value at Decedent's date of death of Trust assets attributable to Decedent's Date 1 transfer of \$z to Trust plus the value at Decedent's date of death of the remainder interest transferred to Trust from CLAT upon Decedent's death.

Law and Analysis:

Section 2601 imposes a tax on every generation-skipping transfer (GST). Under § 1433(a) of the Tax Reform Act of 1986 (the Act), the tax applies to all generation-skipping transfers made after October 22, 1986. Section 1433(b)(1) of the Act provides that, for purposes of chapter 13 of the Internal Revenue Code, any inter vivos transfer made after September 25, 1985, and on or before October 22, 1986, shall be treated as if it were made on October 23, 1986.

A GST is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip. Under section 2612(a)(1), a "taxable termination" means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

Under § 2612(a)(2), if upon the termination of an interest in property held in trust by reason of the death of a lineal descendant of the transferor, a specified portion of the trust's assets are distributed to 1 or more skip persons (or 1 or more trusts for the exclusive benefit of such persons), such termination shall constitute a taxable termination with respect to such portion of the trust property.

Under § 2613(a), for purposes of chapter 13, a "skip person" means (1) a natural person assigned to a generation which is 2 or more generations below the generation assignment of the transferor, or (2) a trust (A)-- if all interests in such trust are held by skip persons, or (B) - (i) there is no person holding an interest in such trust, and (ii) at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a skip person. Section 2613(b) provides that for purposes of chapter 13, the term "non-skip person" means any person who is not a skip person.

Section 2631(a) (in effect on October 23, 1986) provides that, for purposes of determining the GST tax, every individual shall be allowed a GST exemption of \$1,000,000 which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, shall be irrevocable. Under § 2632(a), an individual's GST exemption may be allocated at any time on or before the due date for filing the estate tax return for the individual's estate.

Under § 26.2632-1(d)(1) of the Generation-Skipping Transfer Tax Regulations, an allocation of a decedent's unused GST exemption by the executor of the decedent's estate is made on the appropriate United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706 or Form 706NA) filed on or before the date prescribed under § 6075(a) for filing the return (including any extensions actually granted (the due date)).

Section 2632(c) (redesignated as § 2632(e) effective June 7, 2001) provides, that (1) any portion of an individual's GST exemption not allocated on or before the due date for filing the estate tax return for the individual's estate, will be deemed to be allocated (A) first, to property which is the subject of a direct skip occurring at the individual's death, and (B) second, to trusts with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death. Section 2632(c)(2) provides that the allocation will be made among the properties described in subparagraph (1)(A) and the trusts described in subparagraph (1)(B), as the case may be, in proportion to the respective amounts (at the time of allocation) of the nonexempt portions of such properties or trusts. "Nonexempt portion" means the value (at the time of allocation) of the property or trust, multiplied by the inclusion ratio with respect to such property or trust.

Under § 26.2632-1(d)(2), a decedent's unused GST exemption is automatically allocated on the due date for filing the Form 706, to the extent not otherwise allocated by the decedent's executor on or before that date. Unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)), on the basis of the value of the property as finally determined for purposes of the estate tax (chapter 11 value), first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)) on the basis of the chapter 11 value of the nonexempt portion of the trust property (or in the case of trusts that are not included in the gross estate, on the basis of the date of death value of the trust) to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made. The automatic allocation is irrevocable.

Under § 2602, the amount of the tax is the taxable amount multiplied by the applicable rate. Section 2641(a) defines "applicable rate" as the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is generally defined as the excess of 1 over the "applicable fraction." The applicable fraction, as defined in § 2642(a)(2), is a fraction, the numerator of which is the amount of GST exemption allocated to the trust (or to property transferred in a direct skip), and the denominator is the value of the property transferred to the trust or involved in the direct skip, reduced by any charitable deduction allowed under § 2055 or § 2522 with respect to such property.

Section 2642(b)(2)(A) (in effect on October 23, 1986) provides that if property is transferred as a result of the death of the transferor, the value of such property for purposes of § 2642(a) shall be its value for purposes of chapter 11. Section 2642(b)(2)(B) provides that any allocation of GST exemption to property transferred as a result of the death of the transferor shall be effective on and after the date of the death of the transferor. Under § 2642(b)(3), if any allocation of the GST exemption to any property not transferred as a result of the death of the transferor is not made on a gift tax return filed on or before the date prescribed by § 6075(b), the value of such property for purposes of § 2642(a) shall be determined as of the time such allocation is filed with the Secretary, and such allocation shall be effective on and after the date on which such allocation is filed with the Secretary.

Section 2642(d)(1) provides that if a transfer of property is made to a trust in existence before such transfer, the applicable fraction for such trust shall be recomputed as of the time of such transfer in the manner provided in § 2642(d)(2).

Section 2652(a)(1) provides that for purposes of chapter 13 the term "transferor" means: (A) in the case of any property subject to the tax imposed by chapter 11, the decedent; and (B) in the case of any property subject to the tax imposed by chapter 12, the donor. An individual shall be treated as transferring any property with respect to which such individual is the transferor.

In this case, Decedent established CLAT on Date 1, and funded it with \$w and Class A common stock in Company valued at \$y. The total amount transferred to CLAT by Decedent was \$b. Decedent also established Trust on Date 1, and funded it with \$z. Date 1 is after September 25, 1985, and before October 22, 1986, the date chapter 13 was added to the Internal Revenue Code. Although chapter 13 was added to the Code on October 22, 1986, the provisions of chapter 13 apply retroactively, with certain exceptions, to "any inter vivos transfer made after September 25, 1985," and such transfers are treated as if they had occurred on October 23, 1986. See Tax Reform Act of 1986, Pub. L. No. 99-514, § 1433(b)(1) (1986). Because Decedent's transfers in this case were made after September 25, 1985, they are subject to the provisions of chapter 13.

Decedent was subject to the tax imposed by chapter 12 on the transfers to CLAT and Trust. Therefore, under § 2652(a)(1), Decedent is deemed to be the transferor of

CLAT and Trust for purposes of the GST tax. Also, under § 2631, Decedent had a \$1,000,000 GST exemption available to allocate to these transfers.

Decedent's Form 709 for the Date 1 transfers was filed before chapter 13 was enacted, and therefore, her GST exemption was not allocated on that return. Decedent died on Date 2, a date that was also before Chapter 13 was enacted. However, her Form 706 was due and filed after chapter 13 was enacted, and thus, the estate could have allocated Decedent's \$1,000,000 GST exemption to the transfers made on Date 1. The estate, however, did not allocate any of the exemption on the Form 706. Consequently, Decedent's entire \$1 million GST exemption was allocated under the automatic allocation rules in effect under § 2632(c) on October 23, 1986.

Under § 2632(c), Decedent's entire GST exemption was allocated to Trust because there were no direct skips from Decedent's estate and Trust was the only trust with respect to which Decedent is the transferor and from which a taxable distribution or a taxable termination could occur at or after her death. Trust was not includible in Decedent's gross estate and was not exempt from the GST tax. Therefore, under § 26.2632-1(d)(2), Decedent's unused GST exemption was allocated on the basis of the date of death value of Trust.

The value of Trust in this case consists of two separate parts. The first part consists of the value of Trust assets attributable to Decedent's Date 1 transfer of \$z. The second part consists of the value of the one-fourth share of the remainder interest that passed to Trust under the terms of CLAT. This date of death value of Trust was greater than Decedent's unused GST exemption; thus, Decedent's entire GST exemption was allocated to Trust.

Trust will have an applicable fraction determined under § 2642(a)(2), as follows: The numerator will be Decedent's \$1 million GST exemption allocated to Trust as discussed above. The denominator will be the value at Decedent's date of death of the remaining assets transferred to Trust from CLAT upon Decedent's death plus the value of assets already in Trust attributable to Decedent's transfer of \$z to Trust.

Accordingly, based on the facts submitted and the representations made, we rule as follows:

1. Upon Decedent's death, she had an unused GST exemption of \$1,000,000.
2. Decedent's unused GST exemption was automatically allocated to Trust under § 2632(c) in effect on October 23, 1986, based on the date of death value of Trust, including the value at Decedent's date of death of Trust assets attributable to Decedent's Date 1 transfer of \$z to Trust plus the assets transferred from CLAT to Trust upon Decedent's death.

3. Upon the automatic allocation of Decedent's GST exemption to Trust, for purposes of computing the inclusion ratio of Trust, the denominator of the applicable fraction determined under § 2642(a)(2) should be computed based on the date of death value of the assets of Trust.

4. The numerator of the applicable fraction will be Decedent's entire \$1 million GST exemption allocated to Trust as discussed above. The denominator will be the value at Decedent's date of death of Trust assets attributable to Decedent's Date 1 transfer of \$z to Trust plus the value at Decedent's date of death of the remainder interest transferred to Trust from CLAT upon Decedent's death.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

James Hogan
Senior Technician Reviewer
Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special
Industries)

Enclosure:

Copy of letter for § 6110 purposes